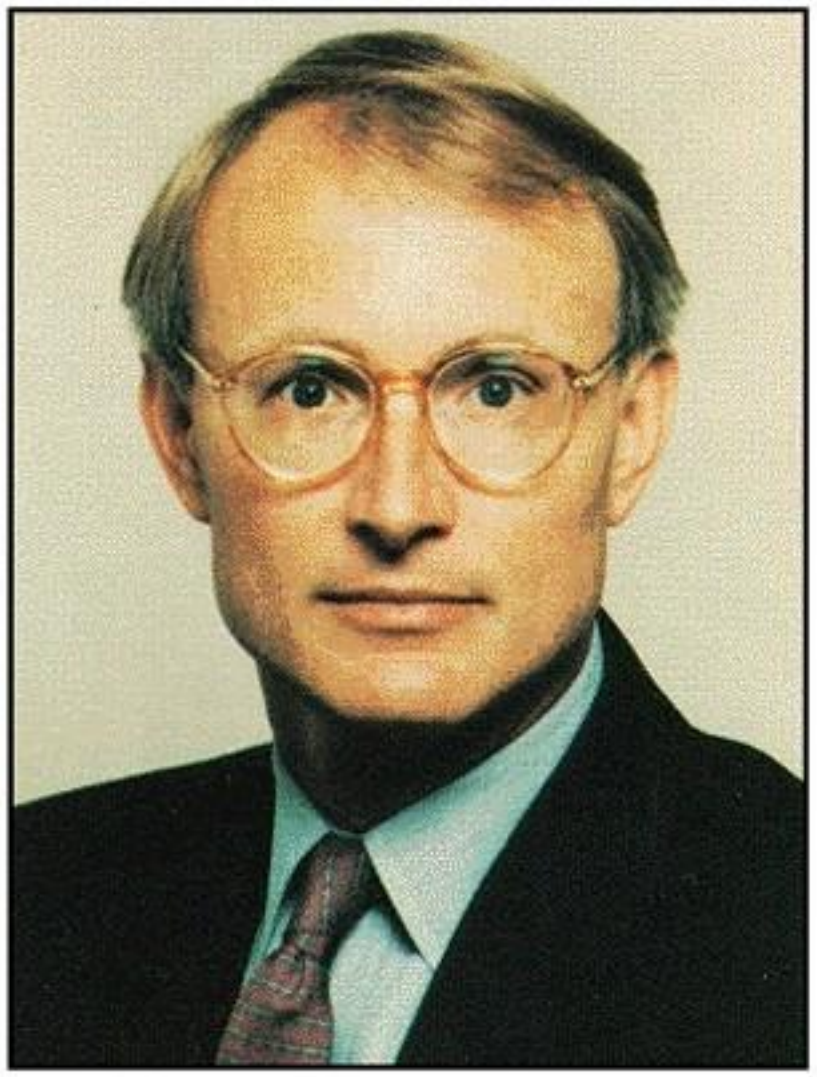
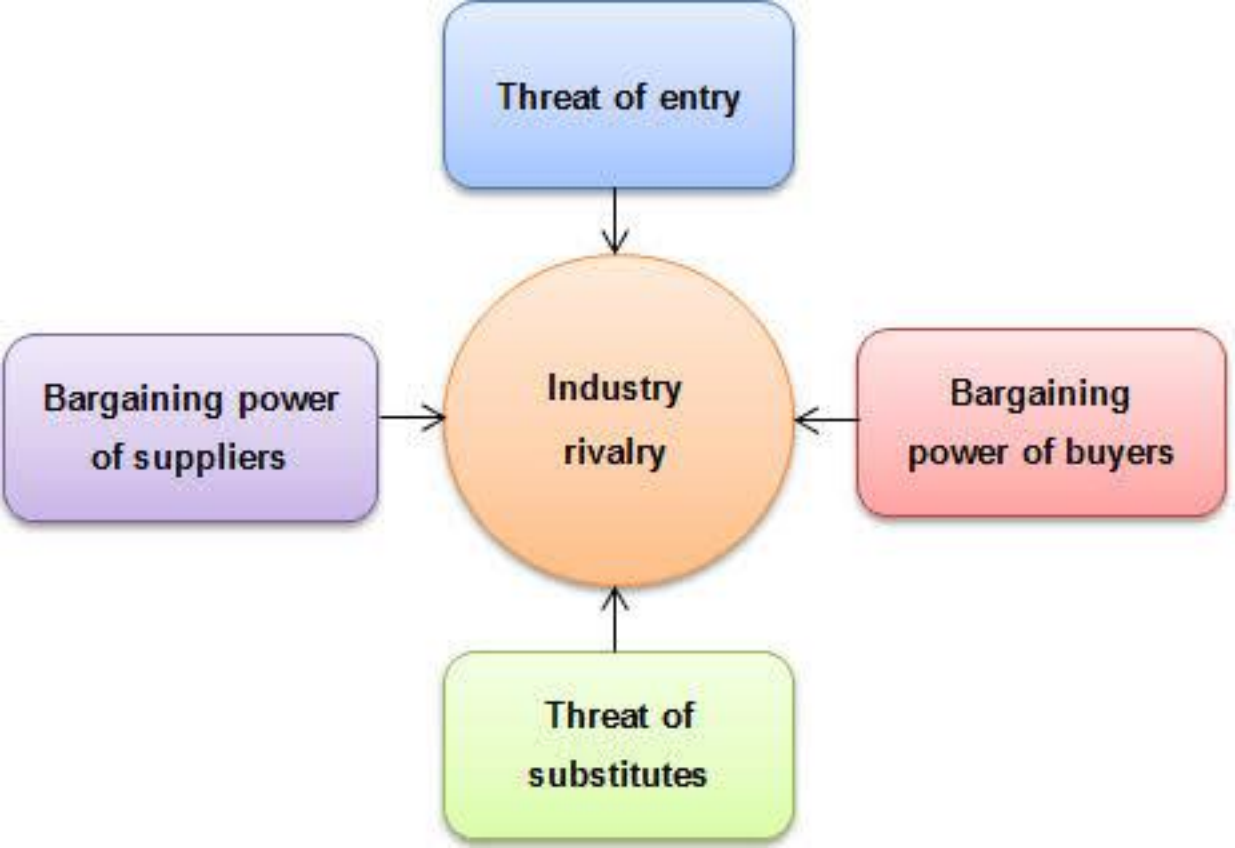
Michael E. Porter's New Approach



- Harvard Business School
- 1980: The Five Competitive Forces
- *The Competitive Advantage of Nations*, 1990.
- First "strategist," a field that is, basically, straight economics
- Enormous popularity


Threat of entry
Bargaining power of suppliers
Industry rivalry
Bargaining power of buyers
Threat of substitutes

The Five Competitive Forces

- the threat of new entrants,
- the bargaining power of customers,
- the bargaining power of suppliers,
- the threat of substitute products or services, and
- the jockeying among current contestants.

Porter and Strategy Today

- Strategy has now become a regular field in management schools. It is mostly a haven for economists.
- Brickley, Smith and Zimmerman devote Chapter 8 to the "Economics of Strategy: Creating and Capturing Value."
- They address Value Creation, which is finding an approach, a cost-reduction technique, or some manner permitting the firm to compete effectively.

Establishing a Strategic Agenda

- To establish a strategic agenda for dealing with these contending currents and to grow despite them, a company must understand how they work in it's own industry and particular situation.
- The essence of strategy formulation is coping with competition.
- Different forces take on prominence, of course, in shaping competition in each industry.
- Every industry has an underlying structure, or a set of fundamental economic and technical characteristics, whether an industry is dealing in services or selling products.

Threat of Entry

- New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources.
- There are **FIVE major sources of barriers** to entry:
  - Economies of scale
  - Product differentiation
  - Cost disadvantages independent of size
  - Access to distribution channels
  - Government policy

Powerful Suppliers and Buyers

- The power of each important supplier or buyer group depends on a number of characteristics of its market situation and on the relative importance of its sales or purchases to the industry compared with its overall business.
- A company's choice of suppliers to buy from or buyer groups to sell to should be viewed as a crucial strategic decision. Most common is the situation of a company being able to choose whom it will sell to, in other words, buyer selection.

Substitute Products

- Substitute products place a ceiling on prices a competing firm can charge, limiting the potential of an industry. Substitutes not only limit profits in normal times; they also reduce the bonanza an industry can reap in boom times.
- Substitutes often come rapidly into play if some development increases competition in their industries and causes price reduction or performance improvement.

Jockeying for Position

Intense rivalry is related to the presence of a number of factors:

- Competitors are numerous or are roughly equal in size and power.
- Industry growth is slow, precipitating fights for market share that involve expansion-minded members.
- Fixed costs are high or the product is perishable, creating strong temptation to cut prices.
- Capacity is normally augmented in large increments.

Formulation of Strategy

1. Positioning the company

1. Influencing the balance

1. Exploiting industry change

1. Recognizing Multifaceted Rivalry